

Message Text

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ACTION EA-12

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-01
INR-07 NSAE-00 USIA-15 TRSE-00 XMB-04 OPIC-06
SP-02 LAB-04 SIL-01 OMB-01 DOE-11 SOE-02 /080 W
-----051335 271043Z /11

R 270810Z JAN 78
FM AMEMBASSY JAKARTA
TO SECSTATE WASHDC 6432
INFO AMCONSULMEDAN
AMCONSUL SURABAYA

UNCLAS SECTION 1 OF 2 JAKARTA 1217

EO 11652: NA
TAGS: EINV, EFIN, ID
SUBJ: UPDATE OF INDONESIAN INVESTMENT CLIMATE STATEMENT

REF: A) 77 STATE 244738, B) 77 JAKARTA 14620, C) 77 JAKARTA A-113

FOLLOWING IS KEYED TO QUESTIONS POSED REF A.

1. INVESTMENT IN INDONESIA IS GOVERNED BY LAW NO. 1 OF 1967 AND SUBSEQUENT MODIFICATIONS. GROWING ECONOMIC NATIONALISM HAS CAUSED HE ESSENTIALLY LIBERAL BASIC LAW TO BE TIGHTENED, PRINCIPALLY BY CLOSING CERTAIN SECTORS TO NEW FOREIGN INVESTMENT AND BY PROGRESSIVELY LIMITING FOREIGN OWNERSHIP AND EXPATRIATE EMPLOYMENT. HOWEVER, THE GOVERNMENT HAS NEVER CEASED TO EXPRESS ITS DESIRE FOR CONTINUED FOREIGN INVESTMENT, AND AS LACK OF INTEREST IN INDONESIA ON THE PART OF NEW INVESTORS HAS IN STEPPED YEARS BECOME MORE APPARENT, THE GOVERNMENT HAS STPPED UP ITS ORAL CAMPAIGN. THE REASONS FOR THIS DWINDLING INTEREST, ASIDE FROM THE CAUTION WITH WHICH MULTI-NATIONALS REPORTEDLY VIEW NEW FOREIGN VENTURES EVERYWHERE, INCLUDE THE RISE IN ECONOMIC NATIONALISM; THE PERTAMINA (STATE OIL COMPANY) CRISIS; FORCED RENEGO-
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TIATION OF OIL CONTRACTS; CORRUPTION; HIGH COSTS; AN UNDER-DEVELOPED INFRASTRUCTURE; SHORTAGE OF SKILLED LABOR AND CAPABLE MANAGERS; AND BUREAUCRATIC INEFFICIENCIES. BECAUSE OF THESE CONSIDERATIONS, NEW U.S. NON-OIL INVESTMENT IN INDONESIA OVER THE PAST TWO YEARS HAS BEEN NEGLIGIBLE. ALTHOUGH THE GOVERNMENT IS ADDRESSING ITSELF TO THESE PROBLEMS, PROGRESS HAS THUS

FAR BEEN SLOW AND MUCH REAMINS TO BE DONE. EXAMPLES OF ENCOURAGING IMPROVEMENTS IN 1977 WERE THE PUBLICATION OF A LIST OF PRIORITIES, WHICH ASSIGNED ONE OF FOUR PRIORITY CLASSIFICATIONS TO NEARLY A THOUSAND POSSIBLE INVESTMENTS AND THE ESTABLISHMENT OF A "ONE-STOP INVESTMENT CENTER," TO SIMPLIFY PROCEDURES AND DESIGNED TO REDUCE DELAYS IN APPROVAL FOR A NEW FOREIGN INVESTMENT.

2. FOREIGN INVESTMENT IN INDONESIA, PARTICULARLY FROM THE U.S., HAS BEEN HEAVILY WEIGHTED TOWARDS MINERALS EXTRACTION. INDONESIA'S POSSESSION OF A WIDE RANGE OF RAW MATERIALS -- PETROLEUM, NATURAL GAS, COPPER, BAUXITS, TIN, RUBBER, TIMBER AND POSSIBLY URANIUM -- WILL CONTINUE TO DICTATE TO SOME EXTENT THE NATURE OF FUTURE FOREIGN INVESTMENT. A SERIOUS OBSTACLE TO MINERALS EXTRACTIVE INVESTMENT IS THAT WHILE SITES OF POTENTIALLY SIGNIFICANT YIELD STILL EXIST, MANY OF THEM ARE IN THE MOST REMOTE, INACCESSABLE PARTS OF THE COUNTRY, NECESSITATING ENORMOUS START-UP COSTS. INFRASTRUCTURE GENERALLY IS LAGGING, WITH INDONESIA OFTEN UNABLE TO MATCH OTHER COUNTRIES IN THE REGION IN SUCH AREAS AS TRANSPORTATION, POWER, WATER AND SEWAGE, FINANCING AND TRAINED MANPOWER. THE INFLATION RATE HAS BEEN HALVED OVER THE LAST TWO YEARS, TO ABOUT 12 PERCENT AND PROBABLY WILL REMAIN AT ABOUT THAT LEVEL. FAVORABLE PRICES IN THE EXPORT UNCLASSIFIED

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SECTOR, IN WHICH FOREIGN INVESTMENT HAS PLAYED A DOMINANT ROLE, HAVE FUELED A GROWTH RATE IN THE 1970'S ESTIMATED AT SEVEN PERCENT. THE DOMESTIC ECONOMY IS DOMINATED BY AGRICULTURE, WITH NEARLY TWO-THIRDS OF THE NATION'S WORK FORCE ENGAGED IN SUBSISTANCE FARMING, TRADING AND GOVERNMENT, AND HAS BEEN MARKEDLY LESS DYNAMIC. INDONESIA'S INDUSTRIAL BASE IS RELATIVELY SMALL AND UNSOPHISTICATED ANDREQUIRES FOR SURVIVAL HIGH PROTECTIVE BARRIERS.

3. INCENTIVES TO INVEST INCLUDE TAX HOLIDAYS, ACCELERATED DEPRECIATION AND EXEMPTION FROM A NUMBER OF DUTIES AND FEES. THE EXTENT TO WHICH THESE INCENTIVES ARE GRANTED DEPENDS UPON THE DESIRABILITY OF THE PROJECT, WHICH IS BASED ON SUCH FACTORS AS EMPLOYMENT CREATION, FOREIGN EXCHANGE EARNINGS OR SAVINGS, DEVELOPMENT OF THE OUTER ISLANDS, TRANSFER OF TECHNOLOGY, ETC. GOI TARIFF POLICY IS DEFINITELY AND INCREASINGLY GEARED TOWARDS PROTECTION OF DOMESTIC INDUSTRY, A POLICY WHICH BENEFITS FOREIGN AS WELL AS DOMESTIC INVESTMENT. GOI INDUSTRIAL POLICY IS TO MOVE PROGRESSIVELY FROM PURE ASSEMBLY TO EVER GREATER LOCAL CONTENT, AND AS THIS OCCURS TARIFF PROTECTION MAY ALSO BE PROGRESSIVELY IN-

CREASED. REPATRIATION OF PROFITS SPECIFICALLY AND THE
ADMINISTRATION OF FINANCIAL AFFAIRS GENERALLY HAVE NOT BEEN
A PROBLEM IN RECENT YEARS.

4. ECONOMIC DEVELOPMENT IS THE GOI'S TOP DOMESTIC
PRIORITY AND THE WARMTH OF TIS WELCOME FOR NEW FOREIGN
INVESTMENT DEPENDS CONSIDERABLY ON THE INVESTMENT'S
POTENTIAL FOR FURTHERING ECONOMIC DEVELOPMENT. A LIST
OF ABOUT FIFTEEN FACTORS, INCLUDING THOSE MENTIONED IN
PARA 3, HAS BEEN DEVELOPED TO ASSIST THE GOVERNMENT IN
GAUGING THIS POTENTIAL. EXISTING INVESTMENTS MAY BE
EXPANDED UNDER ESSENTIALLY THE SAME RULES APPLYING TO
NEW FOREIGN INVESTMENT. PATENT LAW IS RELATIVELY UN-
DEVELOPED AND PROTECTION OF RIGHTS CAN BE A PROBLEM.
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THE GOI'S UNWILLINGNESS TO APPROVE A ROYALTY HIGHER THAN
FIVE PERCENT HAS BEEN THE SOURCE OF SOME FRICTION OVER
THE YEARS.

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ACTION EA-12

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SP-02 LAB-04 SIL-01 OMB-01 DOE-11 SOE-02 /080 W
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R 270810Z JAN 78
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AMCONSUL SURABAYA

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5. UNSKILLED LABOR IS PLENTIFUL AND WAGES ARE CORRES-
PONDINGLY LOW, BUT SKILLED LABOR OFTEN IS IN SHORT
SUPPLY. THE SCARCITY OF MANAGERS HAS LED TO A COM-
PETITIVE SITUATION IN WHICH WAGES HAVE BEEN BID UP TO A
POINT SOMETIMES CONSIDERABLY IN EXCESS OF THOSE IN

NEIGHBORING COUNTRIES. FOREIGN INVESTORS IN MANY INSTANCES ARE REQUIRED TO COMPLY WITH MINIMUM WAGE AND FRINGE BENEFITS AND SAFETY AND HEALTH REGULATIONS MORE QUICKLY AND MORE FULLY THAN ARE DOMESTIC BUSINESSES. FOREIGN-OWNED FIRMS ARE ALSO OFTEN EARLIER TARGETS OF UNIONIZATION EFFORTS (ALTHOUGH THUS FAR AT LEAST UNION PRESSURES FOR HIGHER WAGES HAVE BEEN MODERATE). ALTHOUGH THE GOVERNMENT'S PREFERENCE IS FOR LABOR-INTENSIVE INDUSTRIES, IT NEVERTHELESS HAS WELCOMED HIGH TECHNOLOGY INDUSTRIES WHICH OFFER SCANT EMPLOYMENT PROSPECTS.

6. GOI POLICY ON OWNERSHIP HAS TIGHTENED CONSIDERABLY OVER PAST FIVE YEARS. THE LAWS ARE STILL SOMEWHAT VAGUE BUT WITH FEW EXCEPTIONS FOREIGN INVESTMENTS ARE REQUIRED TO BE JOINT VENTURES. THE GOVERNMENT OFTEN IS THE LOCAL PARTNER FOR LARGER, MORE SOPHISTICATED VENTURES, NOT NECESSARILY BECAUSE THIS IS POLICY, BUT BECAUSE RISK CAPITAL FROM PRIVATE DOMESTIC SOURCES IS INSUFFICIENT.

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INDONESIAN REGULATIONS ISSUED IN 1974 STIPULATE THAT ALL JOINT VENTURES MUST BE UNDER INDONESIAN CONTROL WITHIN TEN YEARS. THE TEN-YEAR PERIOD HAS NOT YET PASSED FOR ANY FOREIGN INVESTOR, SO HOW VIOLATION OF THE GOI WILL ENFORCE THIS REGULATIONS REMAINS TO BE SEEN. SOME OBSERVERS FEEL NEGOTIATION WILL BE POSSIBLE. THE GOI HAS PROVEN TOUGH IN THE FEW INVESTMENT DISPUTES IT HAS HAD WITH WHICH WE ARE FAMILIAR AND A FEW FOREIGN INVESTORS HAVE ALLEGED THAT THEY HAVE BEEN UNFAIRLY TREATED. ONE UNRESOLVED INVESTMENT DISPUTE INVOLVING A U.S. INVESTOR DATES TO THE 1950S.

7. OPIC HAS AN ACTIVE PROGRAM IN INDONESIA, PROVIDING SOME \$216 MILLION WORTH OF COVERAGE, OR 6.9 PERCENT OF THE WORLD TOTAL. WITH THE RECENT DECLINE OF U.S. INTEREST IN INDONESIA AS AN INVESTMENT SITE, OPIC HAS BECOME LESS ACTIVE.

8. THE TWO CHANGES OF NOTE IN INDONESIA'S INVESTMENT POLICIES TO OCCUR WITHIN THE PAST YEAR ARE DESCRIBED IN PARA 1. PARLIAMENTARY ELECTIONS IN MAY 1977 DID NOT, AND A PRESIDENTIAL ELECTION IN MARCH 1978 PROBABLY WILL NOT, RESULT IN SIGNIFICANT ALTERATION OF CURRENT INVESTMENT POLICIES.

9. THE ONLY OFFICIAL PUBLIC SOURCE OF NON-OIL INVESTMENT STATISTICS IS THE CAPITAL INVESTMENT BOARD, WHICH, UNFORTUNATELY, DEALS IN APPROVALS RATHER THAN ACTUAL INVESTMENT. IT IS RELIABLY ESTIMATED THAT THE LATTER IS NO MORE THAN 30-40 PERCENT OF THE FORMER. BOARD

FIGURES ARE AS FOLLOWS: (IN MILLION US\$) UNITED STATES - 702.7; AUSTRALIA - 213.0; BELGIUM - 47.7; CANADA-79.5; FRANCE-30.4; GERMANY (WEST) - 202.9; UNCLASSIFIED

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HONG KONG - 623.3; INDIA - 76.0; JAPAN - 2,589.2; KOREA (SOUTH) - 79.8; MALAYSIA - 60.2; NETHERLANDS-193.6; PANAMA - 28.1; PHILIPPINES - 309.1; SINGAPORE - 978.5; SWITZERLAND - 128.9; TAIWAN - 108.6 THAILAND - 18.5; UNITED KINGDOM - 93.3; OTHER COUNTRIES - 766.1. (FIGURES CUMULATIVE SINCE 1967.)

10. THE FIGURE FOR THE U.S. APPEARS TO BE FAIRLY ACCURATE. IN THE OIL SECTOR IT IS NOT POSSIBLE TO SPEAK OF INVESTMENT IN THE LITERAL SENSE, SINCE UNDER PRODUCTION-SHARING CONTRACTS TITLE TO ALL ASSETS PASSES TO PERTAMINE ONCE THEY ENTER INDONESIA. HOWEVER, U.S. COMPANIES HAVE SPENT AN ESTIMATED \$5 BILLION IN EXPLORATION AND PRODUCTION AND RELATED ACTIVITIES OVER THE PAST TEN YEARS.
MASTERS

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: INVESTMENTS
Control Number: n/a
Copy: SINGLE
Draft Date: 27 jan 1978
Decaption Date: 01 jan 1960
Decaption Note:
Disposition Action: n/a
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment:
Disposition Date: 01 jan 1960
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978JAKART01217
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Expiration:
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From: JAKARTA
Handling Restrictions: n/a
Image Path:
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Line Count: 249
Litigation Code IDs:
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Litigation History:
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Message ID: d3b270df-c288-dd11-92da-001cc4696bcc
Office: ACTION EA
Original Classification: UNCLASSIFIED
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 5
Previous Channel Indicators: n/a
Previous Classification: n/a
Previous Handling Restrictions: n/a
Reference: 77 STATE 244738, 77 JAKARTA 14620, 77 JAKARTA A-113
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 07 mar 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 3702833
Secure: OPEN
Status: NATIVE
Subject: UPDATE OF INDONESIAN INVESTMENT CLIMATE STATEMENT
TAGS: EINV, EFIN, ID
To: STATE
Type: TE
vdkgvwkey: odbc://SAS/SAS.dbo.SAS_Docs/d3b270df-c288-dd11-92da-001cc4696bcc
Review Markings:
Sheryl P. Walter
Declassified/Released
US Department of State
EO Systematic Review
20 Mar 2014
Markings: Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014